

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
2000 Biennial Regulatory Review)	CC Docket No. 00-175
Separate Affiliate Requirement of Section)	
64.1903 of the Commission's Rules)	
)	

WORLDCOM COMMENTS

WorldCom, Inc. (WorldCom) hereby submits its comments on the Notice of Proposed Rulemaking (Notice) in the above-captioned proceeding. In the Notice, the Commission asks interested parties to comment on whether or not the benefits of the separate affiliate requirement for facilities-based independent local exchange carrier providers of interexchange services continue to outweigh the costs and whether or not there are alternative safeguards that are as effective but impose fewer regulatory costs.

The Commission should terminate this proceeding without modifying Sections 64.1901-64.1903 of its rules. Pursuant to Section 11 of the Telecommunications Act of 1996 (1996 Act), biennial review proceedings may evaluate only whether a regulation “is no longer necessary in the public interest as the result of meaningful economic competition between providers of such service.”¹ However, the Notice asks only one question about the level of local competition faced by independent LECs, apparently recognizing that the level of local competition in these LECs’ territories has not changed appreciably in the two years since the Commission adopted the Second Reconsideration

¹47 U.S.C. § 161(a).

Order.² If anything, the competitive picture has grown bleaker over the past two years as numerous CLECs have been forced to curtail their capital spending or exit the business altogether.³ Because independent LECs still do not face “meaningful economic competition,” the Commission should conclude its Section 11 analysis by finding that the Section 64.1901-1903 rules remain necessary in the public interest.

²Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC’s Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Order on Reconsideration and Memorandum Opinion and Order, 14 FCC Rcd 10771 (1999).

³See, e.g., “When Big is No Longer Beautiful,” The Economist, December 14, 2000 (The “new tightness of the capital markets” is “threatening to squeeze the life out of previously highly rated upstarts.”)

Furthermore, the Commission has thoroughly analyzed the relative benefits and costs of the existing rule numerous times during the last twenty years – most recently, only two years ago in the Second Reconsideration Order – and has consistently reaffirmed the validity of the existing rule. Indeed, virtually all of the questions asked in the Notice have already been answered at least twice by the Commission since the passage of the 1996 Act, in both the 1997 LEC Classification Order⁴ and the 1999 Second Reconsideration Order. Because there have been almost no changes in the factors underlying the Commission’s conclusions in those orders, the Commission cannot reasonably reach different conclusions in this proceeding regarding the costs and benefits of the existing rule.

First, there is no reasoned basis for the Commission to reconsider the LEC Classification Order’s finding that independent LECs have the incentive to misallocate costs.⁵ Contrary to the suggestion in the Notice, an independent LEC’s participation in

⁴Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC’s Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756 (1997).

⁵LEC Classification Order at ¶ 159.

the NECA pool does not reduce the LEC's incentive to shift costs from its long distance operation to its local operation.⁶ Because pool participants' revenues are based on the costs that they report to NECA, pool participants have the incentive to misallocate costs in order to maximize their "draw" from the pool.

⁶Those incentives exist not only for rate-of-return regulated independent LECs but for price-cap regulated independent LECs as well; price cap-regulated LECs remain subject to the low-end adjustment mechanism and have the incentive to depress reported earnings prior to the CALLS plan review scheduled for 2005.

Second, there is no reasoned basis for the Commission to reconsider the LEC Classification Order's finding that independent LECs have the incentive to engage in price squeezes or discriminate against other long distance carriers.⁷ Contrary to the suggestion in the Notice, recent changes in the access charge rules or other rules have not reduced independent LECs' ability or incentive to discriminate against their rivals. As long as independent LECs control the local bottleneck, they have the ability and incentive to "discriminat[e] against the affiliate's interexchange competitors with respect to the provision of exchange and exchange access services," in the form of "poorer quality interconnection or unnecessary delays in satisfying a competitor's request to connect to the incumbent LEC's network."⁸ As the Commission concluded in the Second Reconsideration Order, "only the emergence of competition in the local exchange and exchange access markets will eliminate independent LECs' ability and incentive to engage in anticompetitive activity."⁹

Independent LECs' ability and incentive to engage in cost-shifting or anti-competitive activity cannot be gauged by the number of complaints or business disputes involving independent LECs. Because the rules were put in place to deter anticompetitive activity by facilitating detection of such activity, the Commission has consistently rejected independent LEC claims that a lack of allegations of

⁷LEC Classification Order at ¶ 160-161.

⁸LEC Classification Order at ¶ 160.

⁹Second Reconsideration Order at ¶ 14.

anticompetitive behavior demonstrates that independent LECs lack the ability and incentive to engage in anticompetitive conduct.¹⁰

Absent appropriate safeguards, the ability and incentive of incumbent LECs to engage in anti-competitive behavior would result in significant public interest harms. Regardless of the size of the independent LEC or the size of rival long distance carriers, rival long distance carriers would, when faced with anticompetitive behavior by an independent LEC, be forced to exit the market, i.e., at a minimum, the group of point-to-point markets originating in the independent LEC's territory. The resulting reduction in customer choice would allow the independent LEC to raise and maintain its prices above competitive levels, harming consumers within the independent LEC's territory.

¹⁰Second Reconsideration Order at ¶ 14.

The Notice asks whether the distinction made in section 272 of the Act between Bell Operating Companies and independent LECs should guide the Commission in its examination of the continued need for the separate affiliate arguments.¹¹ As is the case with virtually every question asked in the Notice, that question has already been answered by the Commission. Only two years ago, the Commission reaffirmed the LEC Classification Order's conclusion that the imposition by Congress of separate affiliate requirements on the BOCs' provision of in-region long distance services does not foreclose the Commission's consideration, under its broad rulemaking authority, of whether, and which, separation requirements may be appropriate for independent LECs.¹²

¹¹Notice at ¶ 2.

¹²Second Reconsideration Order at ¶ 15.

While not fully compensating for the ILECs' control of bottleneck facilities, the existing rule mitigates some of the risk to competition and consumers. First, the requirement that independent LECs maintain separate books of account deters cost shifting by permitting parties to trace and document improper allocations of costs.¹³ Second, the prohibition on joint ownership reduces the risk of improper cost allocations, and also "helps to deter any discrimination in access to the LEC's transmission and switching facilities by requiring the affiliates by requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities."¹⁴ Finally, the requirement that the independent LEC's affiliate take access services at tariffed rates aids in preventing a LEC from discriminating in favor of its long distance affiliate and reduces somewhat the risk of a price squeeze.¹⁵

The benefits of the existing rule outweigh its modest cost. In the LEC Classification Order, the Commission found that the rule's costs "are not unreasonable in light of the benefits these requirements yield in terms of protection against improper

¹³LEC Classification Order at ¶ 163.

¹⁴Id.

¹⁵Id.

cost allocation, unlawful discrimination, and price squeezes.”¹⁶ Among other things, the LEC Classification Order rejected the argument that the separate affiliate requirement prevents independent LECs from realizing efficiencies from the use of joint resources.¹⁷

¹⁶LEC Classification Order at ¶ 167.

¹⁷LEC Classification Order at ¶ 166.

The alternative approaches suggested in the Notice would not adequately protect consumers and competition. For example, the proposal to allow independent LECs to offer interexchange services through a separate division, and eliminate the prohibition on joint ownership of transmission and switching equipment, would not ensure that all competing in-region providers have the same access to provisioning of transmission and switching as that provided to the independent LEC's interexchange operations.¹⁸ Furthermore, it would be more difficult to ensure the proper allocation of costs if independent LECs were permitted to use the same equipment to provide both local exchange and interexchange services.¹⁹

Proposals to exempt rural LECs or other classes of independent LECs from the separate affiliate requirement are similarly without merit. The Commission rejected such proposals in both the LEC Classification Order and Second Reconsideration Order, finding that “neither a carrier’s size or rural territory will affect its incentives or ability to improperly allocate costs or discriminate against rival interexchange carriers.”²⁰ Because rural carriers and other small carriers are generally rate-of-return regulated, they have a significant incentive to misallocate costs to their local exchange operations and thereby inflate their revenue requirement or the NECA pool’s revenue requirement.

¹⁸LEC Classification Order at ¶ 169.

¹⁹LEC Classification Order at ¶ 163.

²⁰LEC Classification Order at ¶ 183.

Due to the Section 254(g) rate averaging requirement, an increase in the access rates charged by an independent LEC or the NECA pool would harm all long distance customers, not just those served by independent LECs.

For the reasons stated herein, the Commission should retain the existing rule without modification.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I, Barbara Nowlin, do hereby certify that copies of the foregoing Comments were sent via first class mail, postage paid, to the following on this 1st Day of November, 2001.

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